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Supreme Court, U.S.
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No. 97-5310

In The

Supreme Court of the United States

October Term, 1997

DAVID R. BEACH and LINDA M. BEACH, his wife,

Petitioners,

v.

OCWEN FEDERAL BANK,

Respondent.

On Writ Of Certiorari
To The Supreme Court Of Florida

PETITIONERS' REPLY BRIEF

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INTRODUCTION

The question presented, as framed by the Court, is:

> May an action for the statutory right of rescission provided by the Federal Truth in Lending Act, 15 U.S.C. Section 1635, be revived as a defense in recoupment beyond the 3-year limit on the right of rescission set forth in Section 1635(f)?

The answer is "yes," if state law generally allows rescission to be asserted as a defense. The Supreme Court of Florida, however, erroneously concluded that the answer to this question is "no," because that court viewed Section 1635(f) as a strict statute of repose that, after three years, absolutely *prohibits* rescission under state or federal law. The Florida court ruled that no defense of rescission was permitted in state foreclosure proceedings after three years because:

> [S]ection 1635(f) explicitly provides that *both the right and the remedy expire* three years after the closing date. . . .
>
> Therefore, . . . we read that section as unambiguously expressing Congress's intent to extinguish the statutory right of rescission three years after the transaction's closing.

J.A. 170-171 (citations omitted).

That interpretation of Section 1635(f) is wrong. Indeed, the 1995 Truth in Lending Act (TILA) Amendments make clear that the Supreme Court of Florida misconstrued Congress's intent. Section 1635(i)(3) of the 1995 Amendments, which that court deemed to be irrelevant, provides:

> **(3) Right of Recoupment Under State Law**
> Nothing in this subsection affects a consumer's right of rescission in recoupment under State law.

This amendment and its legislative history cannot be reconciled with the claim that rescission in recoupment cannot be raised as a defense after three years. The dissenting judge in the Florida District Court of Appeal recognized that this amendment "runs contrary to an interpretation that Congress intended to treat the right of rescission as a strict statute of repose" that imposes a federal prohibition on raising it as a defense. J.A. 145. Moreover, the right of rescission preserved by this amendment is available under Florida law, which permits rescission based on "an otherwise-expired cause of action to be raised as an affirmative defense or a compulsory counterclaim." J.A. 151. The dissenting opinion reflects the proper view of TILA and demonstrates that if the Supreme Court of Florida had not misconstrued Section 1635(f) as a strict statute of repose the Beaches' rescission defense would not have been barred.

Ocwen itself acknowledges that Congress "in no way meant to preempt the borrower's state law rescission rights if available in recoupment." (Respondent's Br. 18); *accord id.* at 4 (after the time period in Section 1635(f) expires, "borrowers retain whatever rescission rights they have under state law."). Thus, even Ocwen admits that Section 1635(f) does not preempt state law, and that a right of rescission may be revived as a defense in recoupment beyond the three-year limit if state law provides a basis for doing so.

Nevertheless, Ocwen argues that the judgment below should still be affirmed because (1) the Beaches never asserted that they have any right of rescission under state law (Respondent's Br. 2, 7, 8); and (2) state law may only permit rescission as a defense in state proceedings if there is "a showing of fraud, duress, or coercion." *Id.* at 19. The first claim is incorrect because the Beaches relied on both federal and state law, and the Supreme Court of Florida rejected their defense because it concluded that Section 1635(f) prohibited rescission in recoupment under *any* law. The second claim is untenable because nothing in Section 1635(f) or 1635(i)(3) supports Ocwen's claim that federal law allows state foreclosure proceedings to recognize defensive rescission *only* if the defense is based on fraud, duress or coercion.

To the contrary, this Court's prior cases on recoupment show that to prevail on this claim, Ocwen must show that the "clearest congressional language" expressly precludes rescission in recoupment under TILA, state law, and federal common law. Ocwen's argument fails because TILA's language does not contain any language that expressly forecloses post-3-year rescission in recoupment, nor any language that preempts state law from permitting such defenses.

Finally, the hyperbolic submissions of lending industry gloom and doom, which permeate the briefs of Ocwen and its *amici*, are unfounded and irrelevant – unfounded because they are untrue, and irrelevant because complaints about TILA's consequences should be addressed to Congress, not this Court. Long before the Supreme Court of Florida's decision in this action, other courts held that the general principle that defenses based on the

lenders' wrongdoing may be raised as defenses in state foreclosure proceedings applies to defenses of rescission in recoupment based on violations of TILA. These holdings have not brought on any of the disastrous consequences the lenders predict, and this Court should confirm the conclusion of these prior decisions that the time limitation in Section 1635(f) does not apply to recoupment defenses in state foreclosure proceedings.

ARGUMENT

I. THE LANGUAGE AND LEGISLATIVE HISTORY OF TILA SUPPORT THE PETITIONERS' POSITION

A. The Language

"[C]learest congressional language" is the *sine qua non* for finding congressional intent to bar defenses in recoupment. *Reiter v. Cooper*, 507 U.S. 258, 264 (1993) (*quoting United States v. Western Pacific R. Co.*, 352 U.S. 59, 71 (1956)). Ocwen's efforts to overcome this well-established presumption that statutory limitation periods do not apply to defenses in recoupment are unpersuasive.

First, Ocwen argues that Congress has used the clearest language possible because Section 1635(f)'s use of the words "shall expire" could not have been clearer in precluding the statutory right of rescission as a defense in recoupment. *See* Respondent's Br. 12. ("It is difficult to imagine how Congress could have been more clear. . . . "). But where Congress wished to bar recoupment in the past, it has done so by specifically using the terms "recoupment" or "recoup." *See, e.g.*, 14 U.S.C. § 726(d) ("[I]f an

overpayment of pay or allowances results . . . the overpayment is not subject to recoupment"); 26 U.S.C. § 418D(c) ("A plan may not recoup a benefit payment which. . . . "); 29 U.S.C. § 1425(c) ("A [ERISA] plan may not recoup a benefit payment which is in excess of the amount payable under the plan. . . . "); 30 U.S.C. § 191a(c) ("Prohibition against recoupment" [federal mineral leases]) ("[N]o part of any such payment or distribution shall be recouped from the State or other recipient."). The Truth in Lending Act contains no such explicit limitation on recoupment and, as we discuss below, Congress rejected amendments that would have added such a limitation.

Second, Ocwen argues that the rule that a statutory limitation period does not bar recoupment unless the language makes clear that Congress intended to bar such defenses does not apply to Section 1635(f) because this rule "applies only to ordinary statutes of limitation." Respondent's Br. 27. This claim is without merit. Neither *Bull v. United States*, 295 U.S. 247 (1935), nor this Court's more recent cases affirming this rule restrict its application to particular types of limitation periods. To the contrary, *Western Pacific* noted that, even if the limitation period at issue were jurisdictional, this clear statement rule still applied because:

> Only the clearest congressional language could force us to a result which would allow a carrier to recover unreasonable charges with impunity merely by waiting two years before filing suit.

Western Pacific, 352 U.S. at 71. In *Reiter*, the Court commented with approval that the "Courts of Appeals have understood *Western Pacific* as expressing not just a narrow holding based on the United States set-off statute,

but a general principle of recoupment applicable in other contexts." 507 U.S. at 264. This general principle applies here, where the right to rescind grows out of a transaction that violates federal law and the question is whether Congress has clearly said a lender can violate the Truth in Lending Act and escape rescission by waiting more than three years to file a foreclosure suit.

Moreover, contrary to Ocwen's or the Supreme Court of Florida's view, it is not the nomenclature – whether a provision is labeled a statute of "limitations" or "repose" – that determines the availability of the recoupment defense. Instead, the statutory language is determinative. The language of Section 1635(f) does not state that Congress intended to take the extraordinary step of imposing a time limitation on recoupment defenses.

Third, Ocwen acknowledges that in Section 1635(i)(3) Congress has "preserved any state law right of rescission in recoupment from implied preemption." Respondent's Br. 21. This concession is critical because it demonstrates that TILA leaves open the "right of rescission in recoupment under state law."

Ocwen, however, attempts to artificially limit Section 1635(i)(3) by asserting that only "state law" rescission is available, and then only "to borrowers who could prove that they are entitled to the extraordinary relief of rescission, generally by demonstrating actual fraud, duress or coercion." Respondent's Br. 8. This claim, however, is devoid of any support in statutory language or legislative history. Nowhere does the statute intimate such a cramped view of the borrower's right to rescission in recoupment. Nor does it provide any support for

Ocwen's convoluted theory that Section 1635(i)(3) preserves rescission in recoupment under state law only if it is based on the grounds listed by Ocwen, but Congress has preempted states from recognizing the very same remedy if the remedy is based on violations of TILA.

Indeed, it is well established that, unless Congress specifically preempts state action, states may provide remedies based on federal rights and for violation of federal standards. *See Medtronic, Inc. v. Lohr*, 518 U.S. 470, ___ (1996); and *id.* at ___ ("Where a state cause of action seeks to enforce an FDCA requirement, that claim does not impose a requirement that is 'different from or in addition to' requirements under federal law") (O'Connor, J., concurring in part and dissenting in part). There is no reason why state foreclosure proceedings may not recognize rescission in recoupment for violations of TILA, and a number of courts have recognized recoupment defenses based on the federal right.[1] The Supreme Court of Florida, however, erroneously concluded that Section 1635(f) preempted state foreclosure proceedings from permitting rescission in recoupment after three years. Because that reading of the statute is incorrect, the question presented must be answered affirmatively and the decision below reversed.

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[1] *See Dawe v. Merchants & Trust Corp.*, 683 P.2d 796 (Colo. 1984); *F.D.I.C. v. Ablin*, 532 N.E.2d 379 (Ill. App. 1988); *Community National Bank & Trust Co. v. McClammy*, 525 N.Y.S. 2d 629 (App. Div. 1988). Indeed, as noted in our opening brief and emphasized by *amici*, a state may not discriminate against the federal right in applying its law concerning the availability of recoupment defenses in foreclosure proceedings. *See* Petitioners' Br. at 31; Botelho Br. at 20-23.

B. The Legislative History

Ocwen's contention that Congress intended to preclude the statutory right of rescission as a defense in recoupment is also belied by the legislative history of Section 1635(i). In *Bennett v. Kentucky Dept. of Education*, 470 U.S. 656, 665 n.3 (1985), and *New York Telephone Co. v. New York State Dept. of Labor*, 440 U.S. 519, 544 n.44 (1979), this Court noted that Congress's express rejection of proposed legislation can be persuasive evidence of Congress's intent. Such evidence is presented here because in 1995 Congress explicitly rejected proposed amendments that, using the clearest of congressional language, would have prevented any rescission in recoupment beyond the Section 1635(f) three-year period. *See* Petitioners' Br. 23-24; Botelho Amicus Br. 14-16; AARP Amicus Br. 15-19, 21. For example, Representative McCollum's *rejected* bill would have amended Section 1635(f) to make its three-year limitation on rescission "absolute" so that "no consumer may assert rescission, affirmatively or as a defense, in any action in any state or Federal Court after the earlier of the end of the 3-year period . . . or the sale of the property. . . . " H.R. 1184, § 7, 104 Cong., 1st Sess. (1995).[2] The fact that Congress rejected this language, and instead, enacted Section 1635(i)(3) to remove any inference that recoupment rights under state law were preempted, demonstrates that the Supreme Court of Florida misconstrued congressional intent. Moreover, the fact that Section 1635(f) does not include the explicit language

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[2] The full text of section 7 of this bill is set forth in Petitioners' Br. 23, n. 9 and Botelho Amicus Br. 15.

proposed in these 1995 amendments illustrates that Congress could have used language that satisfied the clear statement rule set forth in *Reiter* and *Western Pacific*, but it chose not to do so.

Ocwen argues that this legislative history actually supports its claim that Section 1635(f) requires that a right to rescission be excised within three years of the loan closing, "or be barred forever." Respondent's Br. at 21. The evidence that Ocwen offers to support this claim, however, shows that the assertion is without merit. Ocwen does not cite the language that Congress actually enacted, but relies on the statements of Sen. Mack and Rep. McCollum, the sponsors of the rejected bills, which would have explicitly precluded rescission "in any State or Federal court" after the end of the three-year period in Section 1635(f). *Id.* Such isolated floor remarks do not provide a useful basis for construing the results of the legislative process where, as here, Congress rejected the language proposed by these congressmen and their statements appear to simply resurrect the position that Congress refused to adopt. The floor statement of Senator Sarbanes (*see* AARP Amicus Br. 21), supports the opposite conclusion that Congress decided not to restrict rescission in recoupment, and reflects the only fair interpretation of Congress's rejection of the Mack/McCollum bills. Most importantly, Senator Sarbanes' statement is entirely consistent with the language actually adopted.

That language, Section 1635(i)(3), precludes the precise argument that Ocwen is now making. Ocwen's interpretation that this provision merely preserves state rescission in recoupment law if it is unrelated to TILA is untenable. First, Ocwen's reading of Section 1635(i)

would render the entire provision impermissibly superfluous because TILA already explicitly safeguards such elements of state law (Section 1610(a)(1)), and no case or other authority had ever suggested otherwise. *See United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992) ("a statute must, if possible, be construed in such a fashion that every word has some operative effect"). In addition, Ocwen's interpretation requires that the term "rescission" in Section 1635(i)(3) be interpreted to refer exclusively to some unnamed state law right or rights of rescission, while the meaning of "rescission" in every other sentence in Section 1635 is limited to TILA rescission. That interpretation violates the fundamental rule of statutory construction that the same term appearing in different portions of a statute must be given the same meaning. *See Sullivan v. Stroop*, 496 U.S. 478, 484 (1990).

II. THE TRUTH IN LENDING LAW PROTECTS CONSUMERS AND POSES NO DANGERS TO THE MORTGAGE INDUSTRY

Ocwen's "equitable" and "policy" arguments overlook the fact that Congress has already rejected them. Despite the mortgage industry's opposition to rescission and its efforts to obtain an absolute bar on rescission after three years, Congress has incorporated rescission in recoupment as an appropriate post-3-year remedy. Congress has weighed the policy considerations regarding lenders' liability for Truth in Lending violations, immunizing lenders or limiting the remedies for some violations. The violations here have been determined by Congress to be sufficiently important to permit rescission. Thus, the question in this case is not the amount of the

lender's error, it is whether the rescission remedy can be raised as a defense in recoupment.

Moreover, if questions arise in individual cases concerning whether permitting rescission is equitable, Congress left courts with discretion to consider the equities in such cases: "The procedures prescribed by this subsection shall apply except when otherwise ordered by a court." 15 U.S.C. § 1635(b); *see also* 12 C.F.R. § 226.23(d)(4). Thus, courts are specifically authorized to exercise their equitable power to protect the lender, and many reported decisions provide examples of courts using their equitable authority to ensure that a creditor collects the net principal due. *Williams v. Homestake Mortgage Co.*, 968 F.2d 1137 (11th Cir. 1992); *Shepeard v. Quality Siding & Window Factory, Inc.*, 730 F. Supp. 1295, 1308 (D. Del. 1990); *see also Ljepava v. M.L.S.C Properties Inc.*, 511 F.2d 935, 944-45 (9th Cir. 1975); *Rowland v. Magna Milikin Bank of Decatur*, 812 F. Supp. 875, 881 (C.D. Ill. 1992); *Aquino v. Public Cons. Finance Co.*, 606 F. Supp. 504, 511-512 (E.D. Pa. 1985); *Mayfield v. Vanguard Sav. & Loan*, 710 F. Supp. 143, 146-149 (E.D. Pa. 1989); *In re Michel*, 140 B.R. 92, 101 (Bankr. E.D. Pa. 1992). The decision below, however, is based on the conclusion that there is a rule of law that bars rescission in recoupment three years after closing, and not on any effort to adjust the rescission procedures in light of the equities of this particular case. Whether rescission may result in disproportionate losses to lenders or gains for borrowers in an individual case is irrelevant to whether the Court below correctly concluded that Section 1635(f) prohibits rescission in recoupment after three years in *all* cases.

This Court requires lenders to complain to Congress, not courts, for relief from liability for minor technical errors. *Mourning v. Family Publications Services, Inc.*, 411 U.S. 356, 378 (1973) ("It is not a function of the Courts to speculate as to whether the evils sought to be remedied could better have been regulated in some other manner."); *see also Gennuso v. Commerical Bank & Trust Co.*, 566 F.2d 437, 443 (3rd Cir. 1977). Congress ended liability for minor technical errors in 1980, *Dixie v. Idaho 1st National Bank*, 677 F.2d 749, 753 (9th Cir. 1982), and imposes § 1635 rescission only for material errors. *Steele v. Ford Motor Credit Co.*, 783 F.2d 1016, 1019 n.3 (11th Cir. 1986). Creditors made the technical liability argument to Congress in 1995, leading to the passage of § 1605(f) ("Tolerances for Accuracy"). Congress rejected the technical liability argument for consumers facing foreclosure and elected to protect these consumers even for relatively small technical errors that exceed the low $35.00 tolerance. *See* § 1635(i)(2).

Ocwen and its *amici* also seek to alarm the Court with confusing figures on the potential harm to the secondary mortgage market, should the Court find for Petitioners. The alarums are not convincing. A lender has an affirmative duty to decline TILA-violative loans. *Shepeard v. Quality Siding & Window Factory, Inc.*, 730 F. Supp. 1295, 1301 n. 8 (D. Del. 1990). An assignee who exposes itself to rescission by taking a voluntary assignment of a TILA-violative loan is not "innocent" (Respondent's Br. 30) or "totally blameless" (Fed. Home Loan Mortg. Corp. Amicus Br. 17, 18 n.14). Such an assignee commits a TILA violation by taking the loan. *Shepard, supra*. Congress wanted to restrict free assignment of loans that violate

the Act by making assignees responsible without regard to fault. § 1641(c). If secondary buyers refuse TILA-violative loans, originators will be motivated to close loans that comply with TILA. Restricting secondary purchasers keeps illegal loans off the market and protects consumers by encouraging lenders to comply with the Truth in Lending Act in the first instance.

Neither Ocwen nor its *amici* presents any empirical data to show that rescission after three years adversely affected the mortgage industry, the secondary market or consumers in Colorado, Illinois, or New York, states that have allowed post-3-year rescission in recoupment for up to fourteen years. *See Dawe v. Merchants & Trust Corp.*, 683 P.2d 796 (Colo. 1984); *F.D.I.C. v. Ablin*, 532 N.E.2d 379 (Ill. App. 1988); *Community National Bank & Trust Co. v. McClammy*, 525 N.Y.S. 2d 629 (App. Div. 1988). Neither Ocwen nor its *amici* presents empirical data to suggest that consumers strategically default in Colorado, Illinois or New York. The notion that consumers would risk their homes as part of a strategy to rescind in recoupment under the authority of those cases assumes a degree of calculated scheming or recklessness among consumers that this Court should not indulge.

A decision adverse to Ocwen will not affect the secondary mortgage industry. The industry has thrived under the pre-*Beach* doctrine that rescission in recoupment is not limited to the § 1635(f) period. *Beach* may have raised expectations of post-3-year invincibility in Florida, but in the other 49 states *Dawe* and its progeny have controlled and the secondary mortgage industry has not suffered.

Ocwen and its *amici* claim that 2,700 of 3,500 lenders commit at least one TILA violation, seeking to alarm the Court with astronomical potential liability. Fed. Home Loan Mortg. Corp. Amicus Br. 19 n. 17. The "2,700 lenders who err" argument overlooks the fact that not all TILA errors give rise to or extend the right to rescind; only the failure to provide "material" disclosures does so. 12 C.F.R. § 226.23(a)(3) n.2.

Using the *amici's* proffered data (Fed. Home Mortg. Br. 19 n. 16), it is clear that only a small percentage of loans might qualify to assert the right to rescission. As they posit, only loans that are (1) over three years old, (2) in foreclosure, and (3) a qualifying loan (such as a refinancing), are at issue. That would be, at most, less than one in 1000 existing loans. That number is the product of the various factors:

Loans over 3 years old x in foreclosure x qualifying =

45% (1.8 trillion / 4 trillion) x 0.7% x 40% = .00126

Only 77% of *those* loans contain errors (2,700 of 3,500 lenders), so the final product is 77% x .00126 = 0.0009702. Thus, even assuming that *all* those errors are material and might actually support rescission, the number is less than one in a thousand. In reality, it would be less. And whatever the number – if the industry is violating the Truth in Lending Act – it is the *industry* which should bear the cost of its negligence, not the consumers whom the Truth in Lending Act seeks to protect. *Mirabal v. General Motors Acceptance Corp.*, 537 F.2d 871, 878 (7th Cir. 1976) ("Congress had no intention of having the consumer bear the burden of a creditor's negligence"), *overruled on other grounds, Brown v. Marquette Sav. and Loan*

Ass'n, 686 F.2d 608 (7th Cir. 1982). *Amici's* numbers are a diversion, and the argument that the magnitude of the industry's errors should persuade this Court to overlook TILA's consumer protective purpose and to construe TILA to protect the industry is clearly contrary to congressional intent.

Ocwen, and its *amici*, seek to portray this case as a threat to "a stable and healthy secondary mortgage market." Fed. Home Loan Mortg. Corp. Amicus Br. 26. There is no evidence, real or anecdotal, that supports that submission. This case must be decided based on Congress's plain and clear § 1635(i)(3) statement that TILA rescission in recoupment is alive and well after three years, if state law permits recoupment: "Nothing in this subsection affects a consumer's right of rescission in recoupment under State law."

CONCLUSION

The decision of the Supreme Court of Florida should be reversed and the case remanded for further proceedings in accordance with federal and Florida law.

Respectfully submitted,

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